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Intel. Memo. The Less Developed Countries Face the Oil Price Problem

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Intelligence Memorandum

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The Less Developed Countries Face the Oil Price Problem

Key Judgments

- Higher oil prices will increase the LDC oil bill by about $8.5 billion this year – the equivalent of 2%-3% of their GNP.

- The LDCs have few opportunities to switch to alternative energy sources or to squeeze oil consumption without affecting output.

- Worsening terms of trade could make it even more difficult to pay for oil imports.

- Shortrun reserve drawdowns and increased borrowing can cushion the adjustment this year but subsequently the burden will fall on non-oil imports, with a resulting loss in real income.

- The United States and other aid donors will come under increasing LDC pressure to grant additional assistance. Concessional food aid will be especially sought.

- The United States, the largest LDC creditor, will face rising demands for debt relief.

- US export growth will be adversely affected since part of the LDC adjustment to higher oil prices will be to reduce imports, and the United States is a major LDC supplier.

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted] of the Office of Economic Research, Code 143, [redacted]

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DISCUSSION

Setting

1. For the non-oil producing LDCs as a group, 1973 was one of the best postwar years. With an unprecedented simultaneous boom in most industrial countries during 1972-73, primary product prices rose to record levels. The improved terms of trade led to sharply increased real income for most LDCs, as demand for both foodstuffs and industrial raw materials of all types boomed. Primary product export prices (excluding oil) rose about 50% during 1973. Since the prices of their industrial imports rose much less rapidly, the LDCs sharply expanded their imports while reducing the trade deficit. Net capital flows -- spurred by increased private investment -- also rose, and the LDCs were able to accumulate record foreign reserves. Net capital flows rose by $2 billion to $13 billion in 1972, and a similar rise took place last year. During 1972-73 the LDCs' aggregate foreign reserves doubled to $28 billion.

2. Although the recent prosperity was broad-based, a relative handful of countries accounted for the bulk of the rise in reserve holdings. Several of the poorer food-importing LDCs clustered in Africa and South Asia were severely pinched by the sharp rise in food grain prices and failed to improve their position despite the rise in export prices. Ten countries with only one-eighth of LDC population accounted for three-quarters of the $14 billion growth in reserves. Brazil alone took a third of the rise. Another small group of Western Hemisphere countries, including Chile and Jamaica, and most Central and West African countries lost reserves. Reserves in the populous South Asian countries showed little change.

The Oil Price Problem

3. The LDC oil import bill will leap by $8.5 billion to reach $13.7 billion this year if current prices hold and consumption stays at the 1973 level. Oil will reach about 15% of total imports, compared with 8% in 1973. Thus the expected oil outlay is equal to 24% of total 1973 export earnings by oil-importing LDCs and 50% of their foreign exchange reserves. The rise in their oil bill equals about three-fourths of total net capital flows to these countries from OECD nations. (For a discussion of the impact of the oil bill, by region and country, see the Appendix.)

4. The LDCs will find it difficult to lower their import bill by reducing oil consumption. They collectively consume less than one-fifth as much oil as industrial countries, yet they are more dependent upon oil for energy than the developed world. Latin America, for example, counts

on oil for nearly three-quarters of its primary energy supply. Moreover, much LDC oil consumption is used by industry and for essential transportation. Relatively little is used for automobiles or home heating, and only small savings can be expected.

The Problem Compounded

5. The import financing problem of the LDCs in 1974 and 1975 is likely to be compounded by a worsening in their non-oil terms of trade. Although LDC exports this year should increase, the rate of growth will slow sharply from last year's record 34%. Because of the general economic slowdown in developed countries, raw material demand is expected to slacken and lead to lower prices. Thus far, speculative buying and normal inventory buildup have strengthened demand for most primary products.

6. For several important commodities – cocoa, tea, copra, edible and inedible oils, rubber, and timber -- which account for about 10% of total non-oil LDC exports, prices now appear likely to decline substantially. If the widely forecast upturn for the second half of 1974 in developed economies is delayed or the downturn in the first half is sharper than is generally expected, commodity price weakness will be more pronounced and will spread to most exports (see Table 1). Only natural fibers, because of shortages of oil-based substitutes, and cereals appear likely to be largely immune to sharp prices declines this year and next. These products, however, account for less than 10% of LDC exports.

7. To make the situation worse, prices for LDC imports of industrial goods will rise even more rapidly this year. Inflation in OECD nations has intensified, partly because of the working through of higher prices for energy and other raw materials. Industrial product prices are now beginning to accelerate sharply. The rise in industrial product export prices will probably exceed 15%. This will lead to a deterioration in LDC non-oil terms of trade on the order of 15%-20% -- a loss of some $10 billion in purchasing power, or 15% of 1973 imports; if the falloff in primary product prices is severe, the decline could be even greater.

8. Price trends will continue to pinch severely the food-importing LDCs. In Latin America, Chile, Peru, Guyana, and several Caribbean islands will be affected. In Africa, the Sahel, Ethiopia, and Sudan will continue to be hurt, as will India, Bangladesh, Pakistan, and Indochina in Asia. Because of continued high population growth and crop problems caused by drought and fertilizer and fuel shortages, their need for food imports will remain high. For the same reasons, prices will stay higher for most foodstuffs than for other primary products. This will intensify the terms of trade loss of these and other similarly situated LDCs. Most of

Table 1

Export Prices of Major Product Categories

1967-69 = 100

	1971	1972	1973 1st Half	1973 2nd Half	1974[1] 1st Half	1974[1] 2nd Half
Primary commodities[2]	105	119	154	200	190[3]	175[3]
Food and beverages	116	131	163	200	190	186
Agricultural raw materials	92	115	N.A.	235	241	206
Minerals and metals	102	104	121	168	157	142
Petroleum[3]	132	146	187	242	754	675
Manufactured goods	115	125	136	156[3]	165[3]	175[3]
Selected prices						
Wheat	100	111	162	278	250	219
Rice	66	76	122	229	197	157
Maize	111	107	163	217	196	174
Sugar	128	173	201	216	243	213
Coffee	118	133	162	170	181	166
Cotton	118	124	N.A.	284	312	277
Rubber	80	77	128	190	207	156
Copper	84	84	115	164	137	123
Tin	107	114	129	165	174	158
Zinc	114	139	183	434	415	363

1. IBRD projections.
2. Excluding petroleum.
3. CIA estimates.

these same countries were unable to boost their reserves substantially during the past two years and are particularly vulnerable to further dislocations.

9. The LDCs must also cope with tighter supplies and much higher costs of products derived from petroleum. These include synthetic fibers, plastics, chemical fertilizers, and synthetic rubber. Prices for these products could rise by 50% during 1974, and the supply shortage is likely to hold 1974 consumption to 90% of last year's level. Scarcities of oil-based fertilizers for rice producers throughout Southeast Asia may reduce output, which will limit agricultural exports by some countries and force imports of higher cost foods by others. When these costs are added to the basic oil bill, the burden on the LDCs exceeds by $10 billion the previous year's level.

10. The LDC's aggregate trade deficit will rise sharply during 1974. The oil price rise alone could push the deficit to an unprecedented $16 billion. While LDC non-oil terms of trade are better now than at any time since the early 1950s, they are likely to worsen, which could widen the deficit substantially in 1975. Because OECD nations are also facing sizable deficits, the flow of official capital shows little prospect of rising much to cover this deficit -- unless oil producers provide substantial aid.

Paying the Bill

11. The LDCs will have to cope with higher oil prices by drawing on reserves, increasing indebtedness, and curtailing imports. Over the longer term, increased domestic energy production is an option for some countries. Others, such as the bauxite producers, may try to emulate OPEC, but their success is doubtful. They generally lack the cohesion and financial resources necessary to cut production and exports. Moreover, most LDC exports are not as essential as oil.

12. Many LDCs have accumulated record foreign exchange reserves which can be used to pay the oil bill. Most LDCs will spend these reserves very reluctantly. Moreover, many of the harder hit nations, such as India, Sri Lanka. Chile, Uruguay, and the smaller African nations, have only slim reserve holdings (see Table 2).

13. The more credit-worthy LDCs, such as Brazil, Turkey, and Taiwan, are those that have large reserves and in the short-run are least affected by increased oil prices. Although the share of Eurodollars loaned to LDCs has increased sharply in the last two years and larger deposits by the oil producers will increase the pool of funds, many of the poorer LDCs may be unable to obtain loans. Developed nations are also borrowing, and competition will be stiff.

14. The oil producers have shown a growing appreciation for the need to do something for the LDCs. Unless sustained aid from these countries materializes, a split may develop that would pit the non-oil LDCs against them. Thus far, oil-producer aid schemes are only in the formative stage. An OPEC proposal to form a "Special Development Fund" has yet to be ratified. Iran and Iraq have provided direct relief on a bilateral basis to a few LDCs in which they have a special interest. These credit arrangements may become more widespread in the coming months. While loans will provide some relief to the LDCs, this option cannot be used indefinitely. The debt-carrying capacity of the LDCs and their credit-worthiness would decline rapidly.

Table 2

Oil Importing LDCs: Reserves and Oil Costs

	Billion US $				
	Reserves, Year End			Additional Oil Cost 1974[1]	Oil Cost as a Percent of Reserves
	1971	1972	1973		
Total	14.3	20.4	28.1	8.5	30
Latin America	4.9	8.6	12.6	4.0	32
Of which:					
Argentina	0.3	0.5	1.3	0.4	31
Brazil	1.7	4.2	6.5[2]	1.6	25
Uruguay	0.2	0.2	0.2	0.1	50
Asia	5.7	7.3	9.4	3.1	33
Of which:					
India	1.2	1.2	1.3[2]	0.7	54
South Korea	0.6	0.7	1.0	0.7	70
Pakistan	0.2	0.3	0.5	0.3	60
Philippines	0.4	0.6	1.0	0.4	40
Thailand	0.9	1.1	1.3	0.4	31
Africa	1.7	1.9	2.3	1.0	43
Of which:					
Ethiopia	0.07	0.09	0.18	0.05	28
Ghana	0.05	0.11	0.19	0.07	37
Sudan	0.03	0.04	0.05	0.03	60
Zaire	0.15	0.18	0.24	0.06	25
Zambia	0.28	0.17	0.19	0.03	16
Other LDCs	2.0	2.6	3.8	0.4	11

1. Projected yearend.
2. November.

15. The only long-term solution, if oil prices remain high, will be to adjust imports and exports to eliminate most of the deficit. As time goes on, most LDCs will probably be forced to curtail imports because of the difficulty of boosting export volume. A slowdown of import growth, however, will present substantial difficulties. For most LDCs, the choice will be between current consumption and economic growth. Since financing is more available for capital goods, most LDCs will probably opt to cut consumption. Such moves will be painful. Inflation will be exacerbated regardless of the choices made, and greater political instability is likely as various factions vie for the chance to solve the problem their way.

Implications for the LDCs and the United States

16. LDCs:

- Reduced ability of some countries to pay for food imports increases the possibility of famine, especially in those already plagued by several years of drought.

- Slower growth in the poorer LDCs will heighten the disparity among LDCs and between them and the developed countries. This will eventually sharpen LDC stridency in international forums.

- Higher oil prices will also pit non-oil LDCs against OPEC states should OPEC fail to offer sufficient aid to buy them off. Unless arrangements such as Iran's concessionary oil deal with India becomes more widespread, a deep split could develop among the LDCs, and political support for the Arab cause in the Middle East may be eroded.

- LDCs may ease their restrictions on private foreign investment, particularly in the energy field.

17. The United States:

- The United States will be increasingly pressed to grant more aid. Pleas for food aid will become stronger, and the LDCs will take their case to international forums.

- LDCs will press for commodity agreements to support the prices of their exports.

- The United States, the largest LDC creditor, will face increasing requests for debt relief. With the oil bill, many LDCs will be hard pressed to service existing debt requirements.

- LDC adjustment to higher oil import bills will slow US export growth to LDCs.

APPENDIX

IMPACT, BY REGION AND SELECTED COUNTRY

Sub-Saharan Africa

The oil import bill for sub-Saharan Africa's LDCs will triple in 1974 to an estimated $1.5 billion if last year's import level is maintained. All of the non-oil producing countries would be adversely affected, although the capability of individual countries to absorb the added costs varies widely.

At least seven countries have foreign exchange reserves or expanding export earnings that could support the new oil costs for a year or so. Ethiopia, Tanzania, and Kenya have foreign exchange reserves sufficient to cover the added oil import costs. In addition, Kenya and Tanzania will earn increased revenues from their re-exports of imported crude as refined products. Zaire's small trade surplus will be reversed, the size of the deficit depending on the price of its copper exports. Zambia, Ghana and Ivory Coast may still be able to maintain small trade surpluses in 1974, depending on trends in prices for copper, cocoa, coffee, and timber.

The impact on the trade position and the economies of the remaining 32 oil-importing countries will be more severe. Total foreign exchange reserves in this group stood at little more than $600 million at the end of 1972. Their adverse trade balance that year totaled nearly $1.3 billion. Chad, the Central African Republic, and Mali are among the poorest of these, having combined foreign exchange reserves of only $15 million and imports in 1972 that were one-third larger than exports. Any weakening of export prices for primary product exports of the poorer countries -- iron ore, peanuts, palm oil, cocoa, and other agricultural products -- would further aggravate trade deficits. Without concessionary prices for oil imports or increased financial assistance on soft terms, an inevitable cutback in oil consumption and investment will slow the development of agriculture and the small industries that make up the heart of the emerging modern sector.

Asia

The most pronounced impact of the increased oil price is being felt in the South Asian countries – India, Bangladesh, Sri Lanka, and Pakistan – and the three war-torn nations of Indochina (see Table 3). The cost of 1974 oil imports to South Asian countries will rise to about $2 billion -- that is, the equivalent of existing foreign exchange reserves, or about double net development assistance annually disbursed by developed countries.

Table 3

Selected Economic Indicators

	Million US $					
	Net Oil Cost					
	1973[1]	1974[2]				
	Total	Increase	Total	Balance of Trade 1973[1]	Reserves 31 December 1973[1]	GNP Growth Rate 1973[1] (Percent)
Latin America						
Argentina	150	350	500	960	1,300	4.0
Brazil	850	1,650	2,500	-600	6,500	11.4
Caribbean	515	700	1,215	N.A.	N.A.	N.A.
Central American Common Market and Panama	165	330	495	-420	370	5.0
Chile	120	210	330	-348	300	-6.0
Mexico	85	185	270	-1,700	1,200	8.0
Paraguay	5	8	13	5	75	5.8
Peru	50	90	140	90	570	5.3
Uruguay	50	100	150	25	210	1.0
Near East						
Cyprus	N.A.	N.A.	N.A.	-17	300	1.5
Israel	75	50	125	-2,500	2,200	N.A.
Jordan	12	....	12	-300	325	8.0
Lebanon	40	90	130	-495[3]	1,245	4.0
Morocco	40	130	170	-135	265	6.2
Turkey	175	475	650	-775	2,200	7.5
Africa						
Ethiopia	15	45	60	-40[3]	180	6.0[4]
Ghana	20	65	85	115[3]	190	4.0[4]
Ivory Coast	20	70	90	135[3]	88	8.0[4]
Kenya	55	165	220	-170[3]	233	6.0[4]
Tanzania	45	95	140	-70[3]	145	5.0[4]
Zaire	20	55	75	45[3]	240	7.0[4]
Zambia	30	30	60	195[3]	190	11.0[4]
Asia						
Afghanistan	8	2	10	-50	60	N.A.
Bangladesh	60	90	150	-400	160	N.A.
Burma	6	-1	5	-35	70	2.0
Cambodia	9	27	36	-100	35	N.A.
India	485	715	1,200	-245	1,300	5.0
Laos	10	-2	8	-55	N.A.	N.A.
Pakistan	65	285	350	30	500	5.5
Philippines	200	400	600	15	1,000	8.0
South Korea	300	700	1,000	-675	1,020	17.0
South Vietnam	80	70	150	-655	185	N.A.
Sri Lanka	25	75	100	-45	85	2.5
Taiwan	175	600	775	680	1,880	12.0
Thailand	200	400	600	-490	1,300	5.0

1. Estimated.
2. Projected.
3. Data are for 1972.
4. Data are for 1971.

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Petroleum price hikes are compounding payments problems encountered by South Asian countries struggling to finance costly foodgrain imports necessitated by the 1972 crop failure. India faces considerable hardship and a setback to its gradual recovery from the recent economic slump. Reduction in the use of oil and fertilizers will impact heavily on the agricultural sector, and India is not expected to improve its food self-sufficiency. India will require more than $1 billion additional foreign aid to avoid cutting back essential imports, even with concessions and the financial assistance garnered so far. Similar difficulties experienced by Sri Lanka, Bangladesh, and Pakistan will be compounded by soaring inflation.

For Burma, Cambodia, Laos, and South Vietnam, increased oil costs add one more burden to an already difficult economic situation. Even before the oil price hikes, prospects for expanded exports and improved living standards were poor. Unless foreign aid increases sharply, economic activity in these countries will be slowed by reduced imports.

Most other Asian LDCs will be able to weather the impact of increased oil import costs without severe difficulty. The Philippines is representative of this group. Although its leaders must remain particularly aggressive in lining up credit to offset its small net foreign exchange holdings, total imports and economic growth need not fall much below 1973's good performances. Of more concern will be the impact of imported inflation on domestic political conditions. The sorts of stabilization measures likely to be introduced could cause considerable dissension without significantly contraining price increases below 30% to 40%. Other countries – for example, Thailand, South Korea, and Taiwan – have a more substantial exchange reserve base and better credit positions and may accordingly be able to manage their stabilization problems with somewhat more latitude.

Bangladesh

Petroleum outlays in 1974 will approximate $150 million, 2-1/2 times last year's expenditures for approximately the same import volume. Although Bangladesh, a Muslim country, is a prime candidate for concessionary arrangements with petroleum-exporting states, none have yet materialized. Without price concessions, import costs in 1974 will increase an estimated 27% to about $800 million, as Dacca would like to hold import volume to at least last year's level. Prices for Bangladesh's principal exports, jute and jute goods (85% of total exports), increased about 10% last year. Prices will continue increasing in 1974 but not nearly enough to offset increased import prices. Export revenues in 1974 are expected to be on the order of $350 million, leaving a potential trade deficit of $450 million. Foreign exchange reserves of about $160 million clearly will not be used to finance this year's deficit. Although little information is available on foreign aid availabilities, the amount probably will be well below $450 million, thereby forcing a cut in imports. In turn, reduced imports will frustrate significant economic development.

India

New Delhi is desperately seeking relief from its soaring oil bill by restricting consumption to the 1972 level, soliciting concessionary terms from major suppliers, and spurring domestic energy production. As things now stand, imports of 260,000 b/d of crude and 40,000 b/d of products will cost an estimated $1.2 billion (see Table 4), about one-third of projected export earnings, for the present fiscal year ending 31 March 1975, compared with about $485 million, or 16% of earnings, last year.

Table 4

India: Estimated Balance of Payments

Million US $

	1972[1]	1973[1]	1974[1]
Exports (f.o.b.)	2,605	3,000	3,400
Imports (c.i.f.)	-2,396	-3,245	-4,655
Foodgrain	-78	-600	-700
Petroleum	-271	-484	-1,200
Fertilizer	-120	-200	-500
Other	-1,927	-1,961	-2,255
Trade balance	209	-245	-1,255
Other transactions	-939	-976	-1,010
Debt repayment	-681	-718	-755
Other, net[2]	-258	-258	-255
Overall deficit	-730	-1,221	-2,265
Financed by			
Food aid	13	200	200
Foreign aid[3]	883	950	N.A.
Transactions with the IMF, net	....	75	375
Aid from Iran and Iraq	....	....	250
Total	896	1,225	825
Change in reserves	166	4	N.A.
Additional financing needed			1,440

1. Fiscal year, beginning 1 April of stated year.
2. Including invisibles, autonomous capital movements, and errors and omissions.
3. Including debt relief.

Indian officials have been scrambling all over the Persian Gulf to obtain oil on concessionary terms. New Delhi is attempting to negotiate long-term loans, payment with Indian goods, and a wide range of joint ventures in an effort to improve access to Arab oil. India also is seeking maximum loan and debt relief from the World Bank. In addition, New Delhi has enlisted Soviet technical assistance to accelerate its oil development program and to increase the production of coal.

Petroleum accounts for about 25% of commercial fuel consumption and is used principally by industry and transport. Although New Delhi heavily taxes nonessential uses of petroleum to restrict consumption, petroleum usage has been rising at about 8% to 10% annually. Reduced petroleum supplies in 1974 cannot be replaced by coal and electric power, which will continue to be in short supply. Industrial production is stagnating and shortages of petroleum will slow the country's recovery.

In addition to increased import costs for petroleum, higher costs for fertilizer, food, and other developmental imports will push India's 1974 import bill up 43% to about $4.7 billion. Fertilizer prices have more than doubled. To maintain the 1973 volume of fertilizer, imports will cost New Delhi $500 million in 1974 -- a $300 million increase. Although foodgrain imports ultimately will depend on the rains from this year's summer monsoon, current estimates are 4 million metric tons, about the same volume as last year, costing an additional $100 million. To maintain the country's remaining purchases abroad at about last year's volume will cost an additional $300 million.

Exports alone cannot pay these greatly increased import costs. Prices for most of the country's major exports have increased at a much lower rate than import prices. Cotton textile prices have increased about 25%, and those for jute manufactures about 15%. Further increases are likely in 1974 because of higher prices for synthetics. Tea prices, however, have stagnated. While other exports will benefit from higher world prices, India's total sales abroad will increase only 13% to $3.4 billion in 1974.

India's estimated overall balance-of-payments deficit of $2.2 billion is expected to be reduced about $825 million by

- the $200 million remaining Soviet food loan,
- the $250 million oil concession from Iran and Iraq, and
- the use of a $375 million International Monetary Fund (IMF) standby credit, which currently is being considered by IMF officials.

Iran, which normally supplies about 70% of India's oil imports, has agreed to supply an estimated 48,000 b/d of crude oil annually for five years. The cost of the crude -- more than $11 per barrel -- will be slashed by easy payment terms requiring a $3.50 per barrel downpayment and, following a five-year moratorium, payment of the balance over an additional five-year period at 2.5% interest. A similar Iraqi agreement reportedly will provide 56,000 b/d in 1974. These two agreements will supply India with a total of 104,000 b/d of crude in 1974 at a balance-of-payments savings of more than $250 million.

After accounting for the assistance currently available, New Delhi will still face a remaining deficit of $1.4 billion. With foreign exchange reserves of about $1.3 billion, the equivalent of only about three months' imports at 1974 levels, the government will be reluctant to maintain imports by drawing down reserves. Unused non-project aid of about $450 million cannot be drawn down rapidly, because the bulk of it is tied to specific products and countries. On balance, New Delhi probably would need more than $1 billion additional foreign aid in 1974 to maintain last year's import volume.

Indochina

For South Vietnam, Cambodia, and Laos, totally dependent on imported oil, higher petroleum prices and financing difficulties add another burden to economies already beset with problems resulting from military disruption. Per capita incomes in real terms probably are little changed from those of a decade ago. Moreover, all three countries depend heavily on foreign aid and possess few if any export commodities whose prices will keep pace with the rising prices of imported goods.

The most important source of import financing for these countries -- foreign aid -- has declined in real terms in recent years as the value of this aid has failed to keep pace with increasing dollar import costs. The anticipated doubling of oil import costs in 1974, along with increases in other import costs, will seriously worsen the problem.

South Vietnam's overall import prices are expected to increase by as much as 35% in 1974, bringing the total import bill to nearly $1 billion. Exports are optimistically predicted to reach $100 million this year. Unless US aid increases markedly from the current level of about $500 million, the volume of imports will have to be further reduced.

The South Vietnamese government has taken a variety of relatively successful conservation measures (short of direct rationing) to cope with petroleum shortages, but the impact on the economy still will be serious.

Even though petroleum supplies will almost certainly be cut by 20%-25%, South Vietnam's oil bill will increase by $150 million. South Vietnam's small industrial sector, already in a slump for the past two years, is especially vulnerable to reduced supplies and higher costs. Fuel shortages and price increases also are creating problems in agriculture. Since the mid-1960s the introduction of high-yielding rice varieties and the increasing availability of aid-financed fertilizer and agricultural machinery imports have raised farm incomes and made the country's farming much more dependent on oil and oil-based products. A cost squeeze on farmers will discourage increased commercial production. The forestry and fishing industries, which accounted for almost half of South Vietnam's commodity exports last year, also are feeling the impact of smaller fuel supplies and higher costs. Curtailed activity will reduce output in these industries and could lead to foreign exchange earnings well below earlier anticipated levels.

Cambodia, already experiencing rampant inflation and severe commodity shortages, will be in an even more precarious position as a result of the oil crisis. Petroleum imports currently are financed by US aid, and unless additional aid sources are found, additional oil cutbacks will be required, production will decline further, and inflation will worsen. Laos too will face more inflation and reduced supplies.

Philippines

The Philippine economy, coming out of a good year, is in increasingly good shape to cope with the oil problem for 1974, at least.

In 1973 the economy rebounded from the impact of floods and drought in 1971, under the impetus of unprecedented price increases for its major exports (sugar, coconut products, copper, and timber). The trade balance turned from a deficit to surplus, and foreign exchange reserves jumped from $400 million to $1 billion.

In 1974, higher petroleum prices will raise imports by more than $400 million. At the same time, imports of products other than oil will rise sharply as a result of substantially increased government investment and higher prices for metals, machinery, transport equipment, and chemicals. An increase of 40%-50% in the value of total imports seems likely.

Export earnings in 1974 will probably decline by 5% to 10%. A sharp reduction is expected in the quantity of coconut products exported. Sales of other products -- copper and timber, for example – are likely to grow more slowly than last year because of less buoyant expansion in various developed countries. The trade balance probably will go into the red by about $600 million.

Most of this deficit, however, probably will be covered by official aid, direct foreign investment, and long-term loans. Official foreign aid is likely to continue at the recent rate of about $200 million a year. The accelerated search for oil and other raw materials will attract more foreign capital. With its improved credit rating, the Philippines recently has had little difficulty negotiating long-term revolving credits of $500 million from bank consortia in Europe, Japan, and the United States. It is now seeking further loans of this kind. These receipts of capital should make a precipitous drawdown of foreign reserves unnecessary.

Nevertheless, higher import prices are likely to slow economic growth to perhaps a 5%-6% rate in 1974. Domestic inflation and declines in real personal incomes will present the most difficult and politically pressing problems. Moreover, government countermeasures will have only limited impact because much of the inflation derives from world market pressures. At the end of 1973, real wages in Manila were 20%-25% below their 1965 level, and they have fallen further thus far this year. Civil disturbances are possible if living standards continue to erode.

Sri Lanka

To maintain last year's level of domestic oil consumption (22,000 b/d), Sri Lanka will run up an oil import bill of $100 million in 1974, four times the level of 1973.

The steep increase in the oil import bill, combined with more costly food imports, far exceeds prospective export growth. Higher prices for Sri Lanka's coconuts and rubber are expected to increase export sales by $85 million, compared with a $300 million increase in the cost of imports. The trade deficit will rise from $45 million to an estimated $260 million in 1974. With expected net aid of only $70 million, unchanged from 1973, and little or no cushion in its foreign reserves of $85 million, Sri Lanka will have to rely on short-term foreign credit to cover its deficit.

Managing the deficit will again test Colombo's ability to manipulate short-term credit sources for petroleum and food imports. All of the rice, flour, and wheat imports recently arranged with Australia, China, the USSR, Pakistan, and India were on deferred payment or barter terms -- very little on a concessional basis. As yet, Sri Lanka has failed to secure price or credit concessions for its oil imports.

Although oil and food will be available in quantities equal to last year's, the economy will be affected by the curtailment of other imports. The resulting shortages will constrain industrial output and growth during 1974.

Moreover. Sri Lanka's extensive use of short-term credits poses serious repayment problems during the coming years, and damps future growth prospects.

South Korea

Higher oil prices in 1974 will boost South Korea's oil import bill by an estimated $700 million to about $1 billion. Although the oil bill will strain the balance of payments, economic growth will continue, but at a reduced rate.

The balance of payments has improved in recent years. Exports, largely light manufactures, grew by 90% in 1973, to $3.2 billion, while imports soared to $3.9 billion. The trade deficit was more than offset by private capital inflows, largely from the United States, and by foreign aid. Foreign exchange reserves reached $1 billion at the end of 1973, equal to about three months' imports.

Increased oil import costs plus anticipated increases in purchases of other goods, especially foodstuffs, will raise imports by about 35% in 1974, to an estimated $5.3 billion. Oil imports will account for about 17% of the total. A substantial portion of imports consists of machinery and equipment, prices of which are likely to increase appreciably. The value of grain imports should increase substantially because of higher prices.

South Korea's export growth probably will slow to about 30% in 1974 -- about half the average rate of the previous five years. Growth of demand in Japan, for example – which accounted for almost two-thirds of the increment in South Korean exports in 1973 -- is expected to slow dramatically. Total exports should reach about $4.2 billion.

Given the outlook for imports and exports, South Korea's current account deficit can be expected to increase from $340 million in 1973 to $1 billion in 1974. To offset this deficit, Seoul hopes to attract $1 billion in long-term capital and to increase short-term borrowing substantially, to some $400 million. Korea will be aided in obtaining funds by the notable improvement in its foreign debt position last year. In 1973, debt service payments equaled only 10% of export earnings, compared with 20% in 1971.

South Korea's striking real GNP growth rate of 17% in 1973 was largely the result of growing exports. The expected slowdown in exports will retard economic growth. Some weakening in domestic demand also is likely because of the contractionary effect of higher oil import costs. Should demand fall sharply, many firms would face bankruptcy within a fairly short period because they depend so heavily on borrowing to finance their operations. All things considered, we judge that South Korea's real growth in 1974 probably will slow to 6%-8%.

Inflation will be severe in 1974 because of higher costs for imported fuel and the recent elimination of some price controls. Despite these controls, wholesale prices rose 15% during 1973 because of soaring prices for imported foodstuffs and raw materials. Since December, prices have risen another 20%. The rate of inflation will ease during the second half of 1974 as raw material and fuel prices stabilize.

Thailand

Large foreign exchange reserves and a good credit rating should enable Thailand to bear the increased costs of oil imports with only moderate impact on the economy. Nevertheless, financial conservatism and a caretaker government's indecisiveness could reduce the effectiveness of the government's reaction to its energy problems. The inflationary impact of higher oil prices -- while less serious than in other LDCs -- could heighten public dissent enough to limit the government's freedom to institute necessary courses of action.

The nation's economic performance during the past decade has been strong, although the 1973 real growth rate of 5% was short of the 7% target. Most of last year's growth resulted from a recovery in agricultural output from a weather-induced slump in 1972; an excellent performance in textiles and cement, however, was offset by reduced production of fertilizers, paper, and galvanized metals.

An expected 10% increase in exports in 1974 will fall short of covering the higher oil import costs. A continued strong demand for Thailand's major export commodities (rice, corn, rubber, and tin) should increase exports to just over $2 billion. Increased oil costs, however, are expected to add $400 million to next year's import bill, and total imports should be about $2.5 billion. Nevertheless, with a surplus on non-trade accounts in the balance of payments, foreign exchange reserves at the end of 1974 probably will be about $1 billion.

Domestic inflation this year should be less than in 1973, and the prospects for real growth are good. Wholesale prices rose 23% in 1973, largely because of increased rice prices and a higher bill for imported goods. The government has instituted a number of measures which, even if only partially successful, should slow the rate of inflation in 1974. Real GNP growth should be at least 3% and could be as high as last year's 5% rate.

Latin America

Higher oil bills will slow economic growth and raise prices in many Latin American countries. Soaring oil costs will limit the capacity of several countries to import food, raw materials, and capital goods. Uruguay's oil import bill amounts to more than two-fifths of its export earnings, and economic activity may decline if raw material imports are cut back severely. Several of the smaller Latin American countries, including Costa Rica, Honduras, El Salvador, and Dominican Republic, will be hard hit largely because of meager foreign exchange reserves. The major bauxite producers -- Jamaica, Guyana, and Surinam -- are in particularly difficult positions because bauxite sales have been sluggish and prices have not risen in line with import prices.

Chile probably will be able to cope with oil price hikes in 1974 because of a recent jump in world copper price. With the added copper earnings and the rollover of most of the foreign debt payments due this year, Chile is not handicapped by its weak foreign reserve position or massive agricultural import needs, although if copper prices should fall sharply the economic situation would quickly deteriorate. Lower growth in industrial countries will slow international demand for South American raw materials and manufactured goods. Nevertheless, Brazil's international position will remain strong and the rate of economic growth should be 8%-9% this year. Countries providing most of their own oil needs from domestic reserves -- Argentina and Peru -- will be affected only moderately. Shortages of such petroleum-based material as fertilizers will cause difficulties throughout the region.

Brazil

Brazil's oil import bill in 1974 probably will exceed \$2.5 billion, or more than 30% of anticipated export earnings. But even though the trade deficit will increase by more than \$1.5 billion, Brazil probably will be able to keep its overall payments in balance. In any event, foreign exchange reserves are ample to cover any deficits that might develop.

During the past two years, Brazil's balance-of-payments performance has been exceptional (see Table 5). Exports bounded upward as world market prices for agricultural products rose, and overseas sales of manufactured goods expanded rapidly. In 1973, exports rose by 55% to \$6.2 billion, while imports increased by 42% to \$6.8 billion. As usual in recent years, foreign investment inflows in 1973 more than offset the large current account deficit, yielding a balance-of-payments surplus of \$2.3 billion. Foreign reserves reached \$6.5 billion at the end of 1973, enough to finance 65% of projected imports in 1974.

Table 5

Brazil: Balance of Payments

Million US $

	1972	1973[1]	1974[2]
Exports (f.o.b.)	3,990	6,200	7,800
Imports (c.i.f.)	-4,775	-6,800	-10,000
Trade balance	-785	-600	-2,200
Net services	-160	-110	-100
Net remittances	-515	-640	-700
Current account balance	-1,460	-1,350	-3,000
Capital account balance	3,560		
Errors and omissions	395	3,680	3,500
Change in reserves	2,495	2,330	500

1. Estimated.
2. Projected.

Higher oil prices and the expected expansion of other imports will boost the total import bill by nearly 50% in 1974, to a projected $10.0 billion. Substantial increases in imports of raw materials, intermediates, and capital goods are essential if Brazil's rapid economic expansion is to continue. Brazil's export earnings are expected to continue growing rapidly, reaching $7.8 billion this year. The resulting trade deficit of $2.2 billion would be nearly four times last year's deficit. Large factor payments abroad will push the current account deficit to an estimated $3.0 billion. Net capital receipts, however, probably will be more than adequate to cover the deficit, so that Brazil may not have to draw on its reserves. Brazil's credit standing abroad remains high, and the country remains attractive to foreign investors.

The economy should grow at a brisk though somewhat reduced rate in 1974. Economic growth is projected at 8%-9%, compared with 11% last year. The slowdown will result mainly from minor constraints on imports and further government efforts to reduce inflationary pressures. Even with deflationary measures, inflation is expected to exceed 20%, up from 16% in 1973.

Chile

The rise in world oil prices will boost Chile's oil import bill from $120 million in 1973 to an estimated $330 million in 1974, which equals 17% of projected export earnings. Provided that world copper prices remain high and copper output expands as rapidly as we now expect, Chile should be able to cope with the increased oil import bill in 1974. Lower copper prices, however, could sharply worsen the outlook.

The junta that overthrew the Allende regime in 1973 inherited an economy in shambles. Both copper sales and agricultural output, the economy's mainstays, had declined, and the balance of payments registered a deficit of $900 million in 1972 (see Table 6). Economic conditions improved after the junta took over, reducing the payment's deficit in 1973 to more than $250 million. The improvement was due to sharply increased copper prices and copper production during the latter part of the year, together with growing capital inflows.

Table 6

Chile: Balance of Payments

Million US $

	1972	1973[1]	1974[2]
Exports (f.o.b.)	858	1,171	1,906
Imports (c.i.f.)	-1,432	-1,519	-2,030
Trade balance	-574	-348	-124
Net services	-27	-36	-35
Net remittances	-106	-77	-190
Current account balance	-707	-461	-349
Capital account balance	-236	206	384
Errors and omissions	35	....	....
Change in reserves	-908	-255	35

1. Estimated.
2. Projected.

If the recent jump in world copper prices holds for most of 1974, the balance of payments is expected to improve considerably. Copper prices on the London Metal Exchange (LME) have been hovering near $1.25 per pound, up from $0.88 in September 1973. With copper production at about 850,000 tons, higher copper earnings could push total exports to as much as $1.9 billion. Imports are projected at $2 billion, up about 35% from 1973 because of increased petroleum costs and a rise in agricultural imports to about $600 million. Nevertheless, the resulting trade deficit of $124 million would be the smallest since 1971.

Chile's prospects of obtaining foreign credits in 1974 to cover imports of agricultural commodities and capital goods appear to be good. However, much of the credit will be tied and thus cannot be used to pay for increased oil costs. A Paris Club agreement rolling over $490 million of the debt service payments due this year has greatly eased the strain on Chile's reserve position. Chile now will pay only about $175 million to major Western creditors in 1974. About $100 million owed to other creditors, largely Communist nations and international institutions, has not yet been renegotiated. Because the proceeds from foreign borrowing and investment will exceed the reduced debt payments, Chile is now expected to have a balance-of-payments deficit of about $35 million in 1974.

Chile's economy should continue to recover from the chaos the Allende government created, despite higher oil prices. Economic growth is projected at 5.0% to 7.0%, compared with a 6% decline in GNP last year. The recovery will be the result primarily of increased production of mineral and manufactured goods. Inflation should be reduced substantially from last year's 750%. Chile's economy is particularly vulnerable, however, to changes in world copper prices or to any breakdown in internal security. Thus far, the repressive tactics used by the military have been successful. How long they can be maintained or what will happen as they are relaxed are open questions.